

REPORT OF ACCOMPLISHMENTS

1995 – 1998

“PROTECTING CALIFORNIA’S CONSUMERS”



AGGRESSIVE ENFORCEMENT ACTIONS

Over the last four years, CDI has led an unprecedented effort to punish illegal and abusive insurance practices by insurance providers. Consumers depend upon CDI to enforce the laws and provide consumer protection regarding insurance claims paying, rating, and underwriting. In essence, consumers need a properly monitored marketplace that ensures fair treatment. CDI believes that taking quick and decisive action against “bad” actors in the industry is the most effective strategy for cleaning up the insurance marketplace and preserving the integrity of the industry to make it beneficial for all.

This vision has led the Department to dramatically increase its enforcement activities against insurance carriers and producers over previous years in both volume of cases and dollar amounts recovered for policyholders.

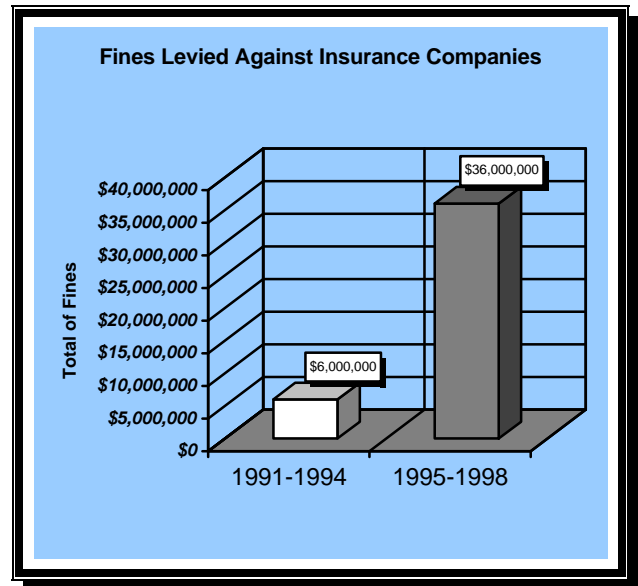
Protecting California’s Consumers

CDI protects California policyholders by closely monitoring the insurance industry for improper and fraudulent claims resolution practices. From 1995 to 1998, CDI completed disciplinary actions against 62 insurance companies and levied over \$36 million in fines – a record for CDI.¹ Notable actions by CDI’s Enforcement Branch include:

- A \$15.4 million penalty against an insurance company for deceptive sales practices possibly affecting hundreds of thousands of company policyholders in California.
- Multi-jurisdictional enforcement action against an insurance company for deceptive practices against its customers in the sale of credit insurance.
- Extensive restitution / remediation for injured policyholders in actions brought against three insurance companies.²

To put the significance of these fines in perspective, during 1991 to 1994, the previous administration levied only \$6 million in fines.

Exhibit 12: Fines Against Insurance Companies, 1991-94 vs. 1995-98



Source: California Department of Insurance, 1999.

Investigative Activities

CDI participated in a multi-state investigation into allegations that the company’s sales agents engaged in improper sales tactics commonly known as “churning.” Evidence uncovered by investigators revealed that thousands of policyholders in California were persuaded by a company’s agents to exchange the cash value of their existing life insurance policies for higher value policies. Customers relied on representations by the company that the cash values of the existing policies were adequate to finance the larger policies at no additional cost. Many Californians were shocked when premium notices subsequently arrived in the mail. Some victims lost their life insurance policies alto-

¹ California Department of Insurance, Enforcement Branch, 1998.

² California Department of Insurance, Enforcement Branch, 1998.

gether when they could not afford the higher premiums. Senior citizens, who had accumulated high cash values by paying premiums for many years, were disproportionately victimized by these improper practices.³

On February 21, 1997, CDI announced a record \$15.4 million fine against the company— the largest single fine in CDI history. As part of this enforcement action, CDI ordered a significant portion of the settlement to be allocated to contacting the company's approximately 625,000 policyholders in California and inform them of their right to pursue relief under a court-appointed remediation program.⁴ By May 12, 1997, the CDI Hotline was receiving an average of 1,800 calls per week from consumers affected by a particular insurance company.⁵ As a result of this outreach program, over 180,000 Californians, or approximately 26% of the eligible company policyholders in the state, applied for relief. This level of participation by consumers was 72% higher than the national response rate to similar actions taken in other states.⁶

Efficiency and Effectiveness

Part of the reason why the amount of fines paid by insurers perpetrating illegal activities has increased in recent years is because the CDI has increased the efficiency and effectiveness of its complaint investigations process. As demonstrated in *Exhibit 13*, the CDI's ability to enforce insurance regulations has been significantly enhanced. The process has been streamlined so investigators can resolve cases more quickly, and thereby handle a greater volume of cases. For instance, the number of cases open 25 months or greater has declined by 70%. High priority cases are also being resolved more quickly; 54% of all "Priority 1" cases

are resolved within 12 months.

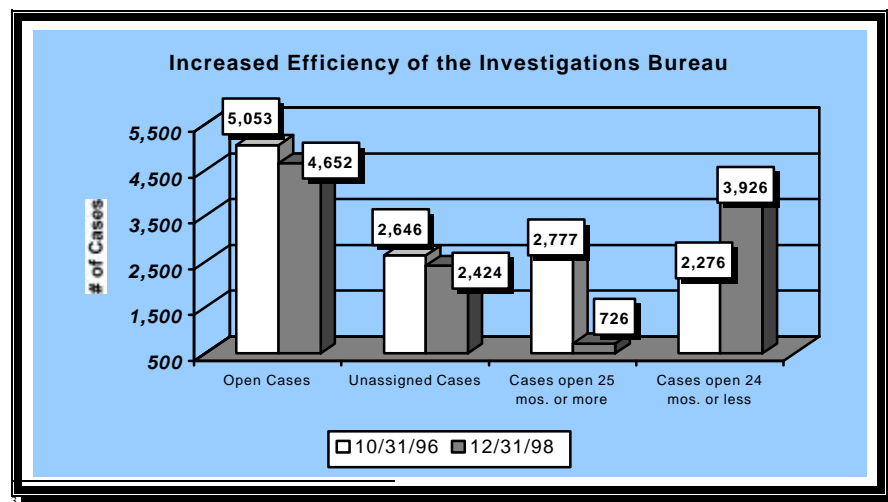
Enacted Consumer Protections to Reduce Illegal Activities by Agents and Brokers

The Department takes its obligation to protect consumers from abusive tactics by insurance providers very seriously. For example, *Eastwood Insurance Services*, a large insurance agency, was fined \$300,000 for transacting insurance through unlicensed persons and acting as an insurance agent for an unlicensed insurer.⁷ Without proper agent licensure, consumers do not have the assurance that they are buying insurance from a competent agent.

An important component of the Department's enforcement policies is its stand against insurance agents and brokers who violate insurance statutes and fair business practices. CDI has completed disciplinary actions against 1,828 insurance agents and brokers, including the revocation of 901 licenses and denial of 252 licenses to "bad actors."⁸ In addition, CDI has sponsored legislation to better protect California consumers against potential abuses by insurance agents and brokers, including:

- Legislation to expand Commissioner's cease and desist authority to stop illegal activities.
- Legislation to expand the power of summary revocation for agents and brokers who have pleaded guilty, or *nolo contendere*, for crimes relating to the business of insurance.
- Legislation to require the licensure of car rental firms and credit insurance sellers to bring those insurance sales-related activities under regulatory oversight and safeguards.

Exhibit 13: Indicators of Investigations Bureau's Increased Efficiency



- Budget augmentation to add 25 employees for FY 1999-2000 to investigate producer misconduct. Adding these 25 employees will greatly assist in eliminating the investigations backlog.⁹

In addition to legislative attempts, CDI has implemented new initiatives to better educate and protect consumers against potential insurance agent or broker abuse, including:

- Creating *Consumer Alert*, an interactive agent/broker licensing database on the CDI Web site.

³ Letter from Commissioner Chuck Quickbush to the Honorable Liz Sivergo, Chair, Assembly Committee on Insurance, dated May 23, 1997.

⁴ California Department of Insurance, Enforcement Division, *Enforcement Accomplishments, 1995-1998*, March 1999

⁵ California Department of Insurance, Consumer Services and Market Conduct Branch, 1998.

⁶ California Department of Insurance, Memorandum dated March 19, 1999.

⁷ California Department of Insurance, 1998.

⁸ California Department of Insurance, Enforcement Division, *Enforcement Accomplishments, 1995-1998*, March 1999.

⁹ Department of Finance Memoranda, 1999.

- Direct mail and media outreach to potential victims to inform them of relief to which they may be entitled.
- Proposed new regulations that will require brokers to provide prospective auto and homeowner clients with CDI's consumer information brochure on buying auto and homeowner insurance.

Enhanced Investigation Capabilities

By the end of 1996, CDI staff had reduced the backlog of 6,500 open cases involving agents and brokers by 25%. CDI has actively sought additional investigators to ensure that all investigations of insurance agents and brokers are completed efficiently.¹⁰ CDI has also successfully sponsored legislation to obtain limited police powers for these investigators and assist them in cracking down on criminal activity.

Also, CDI is attempting to put an end to the practice of fiscal considerations adversely influencing the priorities and decisions surrounding investigations. Because of past budget impediments, the Department has been compelled to focus on performing only those investigations for which it could be reimbursed. This method has led to awkward and often detrimental choices about whether to investigate high-priority non-reimbursable cases or low-priority reimbursable cases.

CDI considers this practice inconsistent with the Commissioner's vision statement. Consumers deserve to have adequate protection against abusive practices and CDI has fought vigorously to obtain the necessary resources to allow investigators to assume the most important cases, regardless of whether the target has assets to pay for the investigation. For the first time in the Department's history, the 1998-1999 state budget included adequate resources to allow Department investigators to focus on consumer protection, instead of budgetary considerations.

Supervise Sales and Underwriting Activities

As California's insurance regulator, CDI closely monitors the sales and underwriting practices of insurers and producers to make sure they adhere to legal and ethical standards, and that claims are handled fairly and according to the provisions of the insurance contract. The objective is to prevent abusive practices that take unfair advantage of consumers; i.e., false sales illustrations or failure to pay legitimate claims on a timely basis. Responding to consumer complaints and performing market conduct examinations are the primary methods by which CDI regulates market practices.

Market conduct examinations are conducted on a routine basis, but can also be triggered by consumer complaints. During a market conduct examination, examiners review a random sampling of a company's policy files and claims files as well as other internal records to ensure that the company is acting in compliance with state laws and regulations. Generally, examiners check to see that the rates charged are consistent with the rates that are filed and approved by CDI, and that claims covered under a policy are paid within a reasonable period of time.

Unfortunately, during 1997 and 1998 both the *Field Rating and Underwriting Bureau* and the *Market Conduct Bureau* suffered major staff reductions. As a result, the number of examinations filed and amount of premiums recovered by the *Field Rating and Underwriting Bureau* decreased; in 1996, 118 examinations were filed and \$2.7 million in premiums recovered. In contrast, only 82 examinations were filed and \$1.2 million recovered in 1997-98.¹¹

Similarly, the effectiveness of the *Market Conduct Bureau* decreased due to staff reductions; in 1996, 48 claims were filed and claim recoveries amounted to \$1.2 million, but by 1998 the amount of claim recoveries was only \$160,390.¹² However, both bureaus recently adopted revised examination procedures that will allow them to greatly increase examination efficiency.

With a focus on personal lines, small business policies, and third party claims activities, both bureaus play a critical role in the oversight and regulation of insurer rating, underwriting, and claims-handling practices.

"Consumer Alert"

Each month, CDI issues a comprehensive listing of the agents or brokers denied the ability to enter the insurance marketplace or whose licenses have been revoked for character or competency. The *Consumer Alert* is a public record of disciplinary action and is available via the CDI Web site¹³ or by calling CDI's Consumer Hotline. *Consumer Alert* is now the third most popular item on the CDI Web site.

Under legislation¹⁴ sponsored by the CDI in 1995, all insurance agents are required to put their license numbers on their business cards and correspondence. With this change in the law, consumers can easily check a producer's license number against those listed in the *Consumer Alert* publication for any possible disciplinary actions.

¹⁰ Senate Insurance Committee Hearing—February 25, 1999, Department of Insurance Responses to Information Requests, p. 3.

¹¹ California Department of Insurance, Field Rating and Underwriting Bureau, March 1999.

¹² California Department of Insurance, Market Conduct Bureau, March 1999.

¹³ CDI Website Address: www.insurance.ca.gov

¹⁴ AB 702 (Chapter 217/July 1995).

Strengthened Surplus Lines Regulation

California law classifies insurance providers as either *admitted* or *non-admitted*. An admitted insurer is licensed to issue policies to consumers who reside in California. While not formally authorized to transact business in California, as an admitted insurer would be, a non-admitted insurer may be permitted to sell insurance in a restricted manner.

For example, consumers who are unable to purchase the coverage they need from admitted insurers, may be able to obtain the coverage they need from a non-admitted insurer through “surplus lines” insurance. Surplus lines insurance is an important and beneficial supplement to the admitted insurance market because some California consumers may have insurance needs that may not always be met through the admitted (i.e., licensed) insurance market, such as sky-diving insurance or insurance to protect a valuable baseball card collection. For this reason, many consumers need access to specialized coverage that admitted insurers might not offer. To help ensure that consumers have access to financially sound and dependable non-admitted insurers, CDI has implemented safeguards in surplus lines insurance.

Formation of the LESLI White List

SB 959 (Chapter 980/Sept. 1994) created the **List of Eligible Surplus Line Insurers (LESLI)**.¹⁵ The bill set forth minimum qualifications that had to be met by a non-admitted insurer in order for that insurer to be authorized to provide coverage through the surplus lines. The legislation also required CDI to establish a public register of all surplus line insurers that have met the minimum eligibility requirements.

To be eligible, a non-admitted insurer must continually maintain a minimum of \$15 million in capital and reserves consisting of assets acceptable under the California Insurance Code.

CDI issued the first LESLI listing on July 7, 1995. The effect is that the surplus lines market has become more restrictive as to the number of non-admitted companies allowed to do business in California. However, because surplus line insurers have to meet minimum qualifications to be eligible for the LESLI list, consumers are better protected.

CDI’s involvement in the area of regulating non-admitted insurers also extends nationally. The Commissioner serves as a member of the National Association of Insurance Commissioners (NAIC) Surplus Lines Task Force, which closely monitors the surplus lines market and its operation. The task force also develops model regulations to both protect consumers and promote that market’s viability.

¹⁵ The Surplus Lines Association of California, *Developments in the Regulation of the Surplus Line Industry*, http://www.sla-cal.org/general_SLALaws-reg/dev-sl.htm.

Currently, there are over 400 surplus line *brokers* licensed by CDI to negotiate and place insurance with non-admitted insurers.¹⁶ To protect consumers, surplus line brokers are generally prohibited from making placements with any non-admitted insurers that have not been placed on the LESLI list.

Reinforced Consumer Services Division

In 1995 and 1996, CDI faced budget restrictions and was forced to layoff 89 positions, including 47 in the *Consumer Services Division*.¹⁷ The layoff alleviated a pressing budget constraint, but such short-term solutions exacted a long-term price. This was especially true with regard to consumer protection endeavors that could undermine efforts to shield consumers from abusive tactics by insurance providers.

Following the budget crisis, CDI promptly sought to restore the positions in the consumer protection unit and has worked for the passage of SB 18 (Chapter 239/Aug. 1997), which provided funding for the Department to restore positions in the *Consumer Services Division*. In 1998, CDI vigorously sought to increase funding for 27 additional consumer service positions that are fundamental in fighting unfair claim practices by insurers. Efforts to increase CDI’s capacity in the *Consumer Services Division* include:

- All 27 positions in the Consumer Services Division and *Market Conduct Bureau* authorized by SB 18 have been filled.
- Increasing *Consumer Services Division* staff by 15 new examiner positions in the 1999/2000 Governor’s budget (includes 10 positions in *Market Conduct Bureau* and 5 positions in *Field Rating and Underwriting Bureau*).
- Increase broader review of all types of insurer claims files with additional positions in the *Claims Services Bureau*.¹⁸

Use of Information Technology to Protect Consumers

To better serve consumers who called with complaints, the *Consumer Services Division* needs to provide accurate and timely responses to consumers. At the beginning of 1995, CDI began aggressively pursuing opportunities in order to be equipped with the latest in consumer protection tools, such as:

- ***Complaints Database System (CDS)***: A nationwide database administered by the Na-

¹⁶ The Surplus Line Association of California, undated pamphlet.

¹⁷ California Department of Insurance Press Release #028, April 24, 1997.

¹⁸ California Department of Insurance, Responses to Information Requests for the California Senate Insurance Committee Hearing, February 25, 1999.

tional Association of Insurance Commissioners (NAIC) used for referencing and analyzing consumer complaints filed with state insurance departments. Complaints reported to the insurance departments are submitted to the NAIC **CDS** database enabling its member insurance regulators to review this information during market conduct examinations and compare complaint experience with premium volume and other insurance companies.¹⁹

- **Producer Database (PDB):** A NAIC administered project²⁰ to provide information relating to insurance agents and brokers (producers). The **PDB** links participating state regulatory licensing systems into one repository of producer information. The **PDB** will also send an electronic notification to state regulators if administrative action is taken against a licensed producer in their state or if a producer no longer holds an active resident license. The key benefits of the **PDB** are:
 - ◆ Immediate access to disciplinary history nationwide.
 - ◆ Immediate electronic notification of administrative action nationwide.
 - ◆ Ability to verify licensures in good standing in all participating insurance regulatory departments.
- **Case Management Program** and an **Automated Case Management System** that:
 - ◆ Establishes objectives for all facets of case management, from initial receipt of alleged law violations to the disposition of completed casework.
 - ◆ Enhances management oversight of investigative case activities.
 - ◆ Enhances investigators' planning and reporting of investigative activities.
 - ◆ Improves time management and reporting.

by CDI have been surveyed and many examined by an independent third party to confirm that prudent steps are being taken to protect policyholders.

Exhaustive steps have also been taken to ensure that CDI, as a business entity within the state government framework, will be prepared internally for the Year 2000.

Furthermore, as a member of NAIC's *Year 2000 Industry Preparedness Task Force* and chair of the NAIC's *Year 2000 Working Group*, CDI participates in nationally coordinated efforts with other states in assessing the industry's state of readiness for the Year 2000. The *Task Force* and *Working Group* provide effective forums to share Y2K-related information among states, such as:

- Current information on specific insurance carrier's state of readiness for Y2K, including contingency plans, compliance costs and external risks.
- Monitoring Year 2000 assessment activities of industry preparedness.
- Providing training and other assistance in developing Year 2000 compliance techniques.



Y2K Assessments

To protect consumers against possible fallout from the "Y2K bug," CDI initiated a comprehensive program to ensure that insurance providers remain capable of meeting their obligations to policyholders when the Year 2000 arrives. Insurance carriers, producers, and others regulated

¹⁹ National Association of Insurance Commissioners, *State Regulation 2000*, Internet site found at <http://www.naic.org/consumer/sr2000/sr2000.htm>.

²⁰ National Association of Insurance Commissioners, *State Regulation 2000*, Internet site found at <http://www.naic.org/consumer/sr2000/sr2000.htm>.